BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
HARVARD A. AND BARBARA A. MOLLEY)

Appearances:

For Appellants: Harvard A. Holley, in pro. per.

For Respondent: James C. Stewart Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Harvard A. and Barbara A. Holley against a proposed assessment of additional personal income tax in the amount of $375.25 for the year 1977.

The issue for determination is whether appellants have established that the loss resulting from the removal of their prune trees exceeded respondent's allowance.

In June 1975, appellants purchased 2-1/2 acres of land in Santa Clara County, together with a new house, for $69,500. The purchase agreement did not allocate any portion of the purchase price to the 189 prune trees located on the property. The trees were 22 to 25 years old and were in partial production of fruit. In June 1976, appellants were advised by the Santa Clara County Department of Agriculture that their trees were infested with shot hole beetles and that it was unlawful, according to state and county regulations, to maintain the trees in that condition. The county notified appellants that all infested wood had to be destroyed and the trees properly maintained. In the event that this was impractical, the county suggested "that consideration be given to completely removing . . . these trees to permanently end the source of infestation.':

Appellants removed thirty trees in 1976 and, after protesting the county's determination that all the trees be destroyed, they removed the remaining trees in 1977. On their income tax returns for those years, appellants claimed bu'siness losses by involuntary conversion. They took deductions for thirty trees in 1976 and for 122 of the remaining 159 trees in 1977, using a value of $100 per tree.

Upon audit, respondent 'contacted the University of California to obtain information on the value of prune trees. Orchard development statistics prepared by the university indicated that it takes five to ten years to achieve a self-sustaining prune crop, that a prune orchard will produce a profitably bearing crop for twenty to forty years, and that it costs an average of $2,790 per acre to develop an orchard. Using an estimate of 109 trees per acre, respondent arrived at a development cost of $25.60 per tree and reduced appellants' claimed losses to $25.60 per tree. This reduction had no tax impact for 1976; however, for 1977, it increased appellants' income. by $9,176.80 and resulted in the issuance of the subject assessment.

Appellants maintain that they did not voluntarily remove the trees but that a government agency ordered them to do so after they had installed an

irrigation system, pruned and cultivated. Mr. Holley, a grocer, says that he comes from a farming family; and

> I knew how to recapture full production from these trees. This is why I bought this parcel of land in the first place. . ..
>
> The trees were definitely showing signs of improvement and would have been in full production in 1 more year.

Appellants note that their deductions were accepted by the Internal Revenue Service.

Respondent contends that the trees were old and neglected, and were not considered to be of any value when the land was purchased. Respondent reports that the Santa Clara County Assessor said orchards in the area of appellants' land had minimal value because the trees were not productive and because most neighboring land was being subdivided for housing.

Revenue and Taxation Code section 17206, subdivision (a), permits a deduction for "any loss sustained during the taxable year and not compensated for by insurance or otherwise." Subdivision (c) limits the deduction to casualty and business losses and to "[l]osses 'incurred in any transaction entered into forprofit ...." For the year in question, respondent's regulations thereunder also allowed a deduction under this section for losses due to government-ordered destruction of farm property. (Former Cal. Admin. Code, tit. 18, reg. 17206(f), subds. (1)(B) and (5), repealer filed Jan. 15, 1981, Register 81, No. 3.) Respondent's auditor agreed with appellants that they had intended to operate the orchard for profit. Hence a loss deduction is permissible under section 17206, subdivision (c), and the sole issue for consideration is the amount of the loss.

Under subdivision (b) of section 17206, "the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in Section 18041 . . " Section 18041., referring to section 18042, reiterates'a general rule that, except where otherwise provided, the basis of property is its cost. The regulation in effect for 1977 explained that the "cost" is the amount the property owner paid for the property. (Former Cal. Admin. Code, tit. 18, reg. 18042(a), subd. (1), repealer filed Aug. 25, 1981, Register 81, No. 35.) In this case the cost of the orchard is unknown because

the property's purchase price was not allocated between the land and the orchard.

Where there is no allocation of the purchase price between the land and the orchard, courts use other factors to compute losses. In George S. Gaylord, 3 T.C. 231 (1944), affd., 153 F.2d 403 (9th Cir. 1946), the tax court allowed the taxpayer a loss deduction for the removal of pear trees. To determine the proper amount of loss, the court used costs of "planting, raising and maintaining a pear orchard [as well as a] comparison of his purchase of the pear orchard with two purchases of property in the same locality," one parcel with and one without pear trees. (3 T.C. at 296.) In F. H. Wilson, 12 B.T.A. 403 (1928), the Board of Tax Appeals allowed a deduction for losses incurred by a taxpayer who destroyed some of his grapevines in order to prevent the spread of a disease. To determine the amount of loss, the board considered the current fair market value of the grapevines and also the cost of bringing the ranch to a state of cultivation, both measures in this case yielding the same estimate of loss, In light of these eases, then, respondent's use of orchard development costs was a legitimate method by which to evaluate the prune trees.

Evidence of the prunes' market value, as indicated in a 1977 report from Sunsweet Company on its prune business, provides secondary support for respondent's evaluation. Sunsweet announced that in 1977, its growers in Glenn County produced the highest local yields per acre, grossing an average of $1,197.00 per acre. This figure, while much higher than the average yield for Santa Clara County, is still only 43 percent of the $2,790.00 per acre deduction that respondent granted appellants.

Additional evidence of the trees' nominal worth is found in the fact that "an expert in the prune business," who was recommended to respondent by the Santa Clara County Farm Advisor, said he claimed a loss of only $4.00 per tree when he removed his own infested prune trees. We also note that many trees in appellants' area were diseased, that neighboring land was being subdivided for housing, and that the California Department of Food and Agriculture and the California Prune Advisory Board have reported a fairly steady decline, between 1966 and 1980, in prune production in much of Santa Clara County. (See also Allen M. Wilson, ¶ 80,514 P-H Memo. T.C. (1980).)

The burden is on appellants to provide evidence to demonstrate that their orchard had a higher value, and that they are entitled to a greater deduction, than respondent allowed. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of Frank G. and Joan Cadenasso, Cal. St. Bd. of Equal., April 10, 1979.) Appellants have failed to meet this burden; on the contrary, the record indicates that respondent's allowance was more than generous. For these reasons, we will sustain respondent's determination.

Appeal of Harvard A. and Barbara A. Holley

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Harvard A. and Barbara A. Holley against a proposed assessment of additional personal income tax in the amount of $375.26 for the year 1977, be and the same is hereby sustained.

Done at Sacramento, California, this 21st day of June, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

, Member